This record is a partial extract of the original cable. The full text of the original cable is not available.

UNCLAS SECTION 01 OF 02 ABUJA 002894

SIPDIS

E.O. 12958: N/A
TAGS: ECON EFIN NI
SUBJECT: NIGERIA: IMF SAYS REAL GDP TO CONTRACT 0.9 PERCENT IN 2002

Summary

¶1. An IMF team in Nigeria for Article IV consultations reported that real GDP will fall by 0.9 percent in 2002, with the oil sector contracting by 14 percent and the non-oil sector--agriculture, manufacturing, and services--growing by about 5 percent. The team says that a growing government budget deficit will spell trouble for the economy by 2003, but the Fund and Nigeria are unlikely to reach any agreement on a new arrangement until after the April 2003 elections. End summary.

IMF Visits Nigeria

¶2. IMF Country Representative for Nigeria Gary Moser and Washington-based IMF Assistant Director for West Africa Menachem Katz on October 18 briefed the diplomatic community on the Fund's Article IV review of Nigeria. The IMF and Nigeria began these consultations in June 2002, but according to Katz, they were postponed so that the team could get a better idea of how the GON,s 2002 budget was being implemented.

Oil and Gas Slipping, Other Sectors Faring Better
--- ----
¶3. Katz said the real economy would contract by 0.9 percent in 2002. He noted that even with Nigerian crude selling at close to $30/barrel, the oil and gas sector is expected to contract by 14 percent in 2002 as a result of the much lower output level that Nigeria negotiated with its OPEC partners. Nigeria agreed to a quota of 1.787 million barrels per day beginning 2002, down from 2.075 the previous year. Recent investments in gas production are only beginning to bear fruit and in 2002 were not enough to prop up the petroleum sector.

¶4. The IMF team reported that agriculture, manufacturing, and services are faring much better in 2002. The forecast for real growth in these non-oil sectors is between 5.0 and 5.3 percent for 2002. Katz attributes most of the success in this sector to a bumper crop on the agricultural side as well as sustained demand for consumer goods and telecommunications services.

Inflation under Control, Exchange Rate Stable . . .
--- ------
¶5. The IMF team reported that year-on-year inflation for 2002 will be about 13.4 percent, down from about 18.9 in 2001. Katz credited most of the decrease in the rate of inflation to the rise in agricultural output, which resulted in lower prices for food items.

¶6. Meanwhile, the IMF says that the introduction of the Dutch Auction System has made for a dramatic improvement in exchange rate policy. The Naira now trades at between 127 and 128 to the dollar, about 5.0 percent depreciation from before the auction was introduced in July 2002, when it traded at about 121. The team noted that there is still room for improvement, however, suggesting that the 9.0 percent differential between the parallel market and Central Bank rates was still unacceptable. Moser previously told econoffs that the IMF has recommended to Nigeria that there be no differential, and the markets should be unified.

¶7. Comment: That Nigeria unify its foreign exchange markets is a long-standing demand of the IMF, but it is unlikely to happen any time soon. Were it to happen, the Central Bank would quickly run through its foreign exchange in an attempt to prop up the naira. The alternative, allowing the naira to depreciate, would not be tolerated by the political elite who believe it is a symbol of Nigerian economic power and, maybe more to the point, depend on it for cheap imports. End comment.

. . . but Government Deficit Could Reverse those Trends
--- -----------
¶8. The IMF team expressed concern that the large 2002 budget

deficit could spell serious macroeconomic problems. The IMF considered the President's budget too expansionary; the budget put forward by the National Assembly was even more so. Katz said President Obasanjo had recognized that the budget put forward by the legislature was unrealistic and had ratcheted down spending considerably; even so, Katz estimates that the 2002 deficit will be 5.7 percent of GDP, up from 4.0 percent in 2001. He explained that the fall in revenues caused by the contraction in the oil sector is not the real problem--actual government oil revenues for 2002 are well above the amount budgeted. Unconstrained--that is, more than budgeted for--spending on civil service wages and pensions as well as on capital projects is to blame, according to Katz.

¶9. The question is, how will the GON finance the budget deficit? Katz suggested two possibilities. The Central Bank can monetize the deficit by buying debt from the GON and paying for it with freshly minted naira. If the Central bank were to decide to defend the naira in response to the increasing inflation that would result from monetizing the deficit, the end result would be a significant fall in the bank's foreign exchange reserves. The other option is to securitize the government's debt. Under this scenario, the Central Bank might sit back and watch interest rates rise as a result of the growing government budget deficit; with a larger supply of government debt on the market, the interest rate on that debt will be forced up to attract buyers.

¶10. Katz explained that, in either case, the result will be a fall in investment and trouble down the line for the real economy. With high inflation, the cost of inputs would increase; with high interest rates, financing would be more expensive. In either case, output would fall. Comment: It is extremely difficult to stabilize the macroeconomy in an resource-dependent developing country. A sharp increase or decrease in either output or prices might dramatically alter macroeconomic scenarios. End comment.

Now What?

¶11. Moser said that the IMF Board of Directors will meet on December 18 to review the Fund's Article IV consultations with Nigeria. Implying that the Fund has no plans to renew its program with Nigeria in the short term, Moser said the Directors would likely discuss a future engagement with Nigeria to begin after April 2003 presidential elections. (Comment: The sentiment among the GON leadership is that Nigeria doesn't need another IMF program and can move forward on its own. Moser told us that President Obasanjo becomes annoyed at the mere mention of the IMF. It will probably take a crisis, economic or otherwise, to force the GON back to the table with the IMF. End comment.)

Comment

¶12. Diversifying the economy, by using the proceeds of oil and gas production to create a better climate for investment in other sectors, remains the most pressing challenge for GON economic management--as it has for over thirty years. However, the non-oil economic growth that occurred in 2002--bumper crops in agriculture due mainly to good weather and windfall profits in telecommunications reaped as Nigerian GSM service catches up with the rest of the first-tier developing countries--is not the kind of diversification that is needed. The GON's medium-term development plan--unveiled by President Obasanjo's Chief Economic Advisor Magnus Kpakul at the Ninth Nigerian Economic Summit--is a good step toward conceptualizing what needs to be done to reduce dependence on oil. Sustainable growth calls for the GON to improve Nigeria's non-oil infrastructure, harmonize and stabilize its fiscal and monetary policies, and establish a regulatory and legal environment that encourages competition in key sectors of the economy (Lagos septel). End comment.

JETER